BILL # HB 2549

TITLE: ~~healthy forest pilot program~~
(NOW: healthy forests; tax credits)

SPONSOR: Chase

STATUS: Senate Engrossed

REQUESTED BY: Senate

PREPARED BY: Brian Cary

FISCAL ANALYSIS

Description

The bill provides for the state Department of Commerce to certify qualified businesses that process and add value to biomass from Arizona's forest areas. Qualified businesses are eligible for individual and corporate income tax credits based on net increases in employment, and sales and use tax exemptions for qualified construction and equipment. A business can claim a credit for up to 200 new jobs. The bill provides for income tax credits and sales tax exemptions to be forfeited, or "clawed back," if a business' certificate is revoked. The bill also requires the Arizona Department of Administration (ADOA) to develop a program to contract for purchasing electrical energy produced from biomass resources. The bill establishes the State Forester position within the State Land Department and creates the State Urban-Wildland Fire Safety Committee.

Estimated Impact

The JLBC Staff has the following main observations about the bill's fiscal impact:

1. The impact would largely depend on whether any new economic activity would have occurred in the absence of this legislation. If the bill's tax incentives induce economic activity that would not have otherwise occurred, then any General Fund revenue impact would be considered foregone revenue and not a reduction in the existing tax base.

2. We cannot predict in advance the level of new tax credits and sales tax exemptions. We do not know the number of existing companies that could qualify for the credit or the amount of new jobs that could be generated.

3. The income tax credits can only be taken if new jobs are created. Setting aside the issue of whether the jobs would have been created in the absence of this legislation, new employment creates secondary economic benefits as the new wages have ripple effects through the economy. This type of secondary, or dynamic impact, is difficult to estimate with certainty. Our dynamic models, however, suggest that the corresponding increases in tax collections from 200 new jobs per business would roughly offset the cost of the income tax credits for that business.

4. There are administrative costs associated with establishing the position of State Forester and defining its related duties. JLBC Staff estimates the bill's State Forester provisions could cost at least $100,000 from the General Fund in future years. The actual administrative costs will depend on how the Land Department implements the bill.

5. There could be costs from requiring the ADOA to develop a biomass electricity purchasing program. At current wholesale electricity market prices, biomass-generated power costs about twice as much as power from conventional sources. Since the bill does not require the state to purchase biomass electricity, there would be no mandatory additional expense from this provision.

The Department of Revenue was unable to estimate the net revenue impact of the bill, but does not believe the impact of the tax provisions would be significant.

Analysis

Tax Incentives

The bill provides tax incentives similar to the incentives in current statute for enterprise zones, including individual and corporate income tax credits for new employment. In addition, the bill provides transaction privilege tax (TPT) and use tax exemptions for the purchase and rental of qualified equipment and the construction of new facilities.

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Analysis (Cont'd)

The key to determining the impact on income, sales, and contracting tax collections is to draw a distinction between 1) new economic activity and 2) activity that would have occurred regardless of the bill. It is realistic to expect that some new investment could be stimulated by the incentives provided in the bill. However, it is possible that some existing businesses could qualify for the tax credits and exemptions, reducing their tax liability. Since JLBC Staff is not able do identify all of these businesses and their existing tax liabilities, we cannot calculate this impact.

Income Tax Credits

The bill creates individual and corporate income tax credits for new jobs. For taxable years January 1, 2005 through December 31, 2014, a credit is allowed for net increases in qualified employment of Arizona residents by a qualified business. The credit is for: 25% of taxable wages up to $500 in the first year of employment; 1/3 of taxable wages (33.3%) up to $1,000 in the second year of employment; and, 50% of taxable wages up to $1,500 in the third year. The bill sets a series of requirements for the jobs to qualify for the credits, including residency, health insurance benefits, and threshold wage levels. A business claiming the credit must create at least 10 new jobs. A maximum of 200 positions per taxpayer can be claimed in a year. The credits are non-refundable and may be carried forward for five years. For example, if a business were to add the maximum 200 qualified jobs in tax year (TY) 2005, they would be eligible for income tax credits totaling $100,000 in TY 2005, $200,000 in TY 2006, and $300,000 in TY 2007, respectively.

Businesses located in Arizona's enterprise zones are eligible for job creation income tax credits that are identical to those provided by HB 2549. (This legislation, however, requires a company to be part of the biomass industry and does not limit the credit to firms in a particular geographic area.) According to the Department of Revenue, 153 individual taxpayers claimed $1.6 million in enterprise zone tax credits in 2001, the latest data available, while 111 corporations claimed another $5.6 million. In 1999, 128 corporations and 143 individuals combined to claim $13.4 million in enterprise zone tax credits, which was the largest annual total to date.

The bill requires qualified businesses to create new jobs in order to claim the related tax credits. The jobs are required to be relatively well-paid, full-time positions with benefits in order to qualify for the credits. This would add net revenue to the General Fund, with the amount depending on the number of jobs added, the wages and associated income taxes paid, and the additional impact of consumption-related taxes on sales, property, etc.

Precisely determining the direct impact of tax legislation is a difficult task, since it often relies on assumptions and the best available data on tax collections. Determining the indirect impact compounds these difficulties because it requires the analyst to rely on simulations of economic behavior rather than on actual observations. Therefore, the strength of the dynamic estimate relies entirely on the accuracy of the model in simulating real world behavior. While we will continue to improve our understanding of the dynamic estimation process, it is important to acknowledge the inherent uncertainty in all dynamic estimates.

To simulate the impact of the income tax credits, JLBC Staff used the IMPLAN model developed by Elliott D. Pollack & Co. to estimate the effects of creating 200 wood products manufacturing jobs in Navajo County. The IMPLAN model uses a local economy's industrial structure and labor market characteristics to calculate the impact of proposed economic development scenarios. The direct and indirect impact would include 420 total jobs and $13.2 million of personal income in the first year. The fiscal impact includes $308,000 in state sales tax receipts and $190,000 in individual income tax payments for a total of $498,000. Although 200 new jobs would generate $300,000 in income tax credits by year 3, the cost could be offset by the indirect economic impact of $498,000. In addition, the cost only occurs if it is a reduction in existing liability – otherwise, credits to new businesses are foregone revenue and not a reduction in the existing tax base.

JLBC also used the IMPLAN model to estimate the impact of creating 200 wood products manufacturing jobs in Maricopa County. The direct and indirect fiscal impact included $189,000 in state sales tax receipts and $184,000 in individual income tax payments for a total of $373,000. Since Maricopa County is an urban area with a highly developed infrastructure of service-providing businesses, the indirect impact would be smaller than in a rural county where new job creation would stimulate more new services and retail activity.

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Analysis (Cont'd)

Sales Tax Exemptions

The bill establishes a contracting sales tax exemption for qualified businesses. To qualify for the contracting tax exemption, construction must begin by January 1, 2010. The bill also provides: a transactions privilege tax (TPT) exemption for machinery and equipment purchased by a qualified taxpayer; a TPT exemption for personal property rentals and leases; and, a use tax exemption. To qualify for the exemption, equipment must be purchased after June 30, 2004. The potential tax revenues lost to the General Fund would be approximately 5.6% of the value of construction and the value of equipment purchased by qualified businesses. The purchases and construction would represent foregone sales tax revenues, and not a loss to the current General Fund base, as long as that activity would not have occurred in the absence of the bill.

Electricity Purchasing Contracts

The bill requires the state ADOA to develop a program to contract for purchasing electrical energy produced from biomass resources. Contracts would be limited to ten years. Contingencies must be provided to allow for cases where biomass energy does not meet predicted generation levels. The contracts would be audited every five years. At current wholesale market prices, biomass-generated electricity costs about twice as much to produce as power from conventional sources. If the price of natural gas and other fuels rises over time, the cost difference could narrow. However, the bill does not specifically require ADOA to purchase biomass electricity. The fiscal impact will depend on how much electricity that ADOA chooses to purchase at above-market prices. According to ADOA, development of the program and purchase contracts would require an initial request for proposals costing $50,000 or more in staff time and professional consulting services.

State Forester and Urban-Wildland Fire Safety Committee

The bill establishes the position of the State Forester within the State Land Department and defines related qualifications and duties. The Land Department estimates that the bill, as amended by the Senate Natural Resources and Transportation Committee, would cost them $540,000 to implement. We have not received an estimate from the Land Department on the fiscal impact of the Senate Engrossed version of the bill.

According to the Land Department, the cost of creating the position of State Forester would be about $20,000 in order to upgrade an existing position to meet the new requirements. The bill requires the State Forester to 1) identify sources of information and 2) develop procedures to compile and transmit information on forest management, wildfire suppression, litigation, timber sales and forest thinning projects. The Land Department currently serves as the State Cartographer and has some GIS mapping capability, but the staff believes the bill requires the State Forester to significantly expand this function. According to the Land Department, a minimum of three positions would be needed, along with money for software, computer equipment, and related maintenance. The department estimated these costs to exceed $300,000.

In addition, the bill requires the State Forester to conduct education and outreach activities in forest communities. The Land Department estimates a cost of one FTE position and $60,000 to implement these provisions. The Land Department also estimates that another $160,000 would be needed for an interagency agreement with the Attorney General. This would provide for two attorneys and one administrative position to perform work that requires the State Forester to intervene on behalf of the state in appeals and litigation if the State Forester determines that intervention is in the best interests of the state.

Given the State Land Department's existing resources, JLBC Staff estimates the bill could cost at least $100,000 from the General Fund. The bill adds additional administrative requirements for the department by creating the State Forester position, adding information collection responsibilities, and specifying a role in potential litigation. The State Land Department and the State Forester would have some discretion in how the new administrative responsibilities are implemented. Their decisions may affect whether future budgets include requests for additional monies to implement the bill's provisions. The JLBC Staff does believe, however, that existing personnel could be used to offset some of the bill's provisions, such as to staff the State Forester's education and outreach activities.

The bill also creates the State Urban-Wildland Fire Safety Committee, which would not result in a significant cost.

Local Government Impact

Cannot be determined.